# SECOND QUARTER INTERIM REPORT
# JUNE 30, 2010

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## Corporate Profile

SaskEnergy Incorporated (SaskEnergy or the Corporation) has the legislated franchise for the distribution and transmission of natural gas within Saskatchewan. The distribution system delivers natural gas to over 347,000 residential, farm, commercial and industrial customers over a 67,000 kilometre pipeline distribution system. The transmission system provides transportation and storage services to the distribution utility, producers, marketers and large volume end-use customers within Saskatchewan.

SaskEnergy has six wholly owned subsidiaries:

- TransGas Limited – owns natural gas transportation and storage facilities;
- Many Islands Pipe Lines (Canada) Limited – transports natural gas to and from other jurisdictions and is regulated by the National Energy Board;
- Bayhurst Gas Limited – owns, produces and sells natural gas from storage-related assets and holds natural gas royalty interests;
  - Bayhurst Energy Services Corporation – a wholly owned subsidiary of Bayhurst Gas Limited and operates as an energy services company;
- SaskEnergy International Incorporated – holds international equity investments;
- Swan Valley Gas Corporation – owns a natural gas distribution utility in the Swan Valley area of western Manitoba;
- Saskatchewan First Call Corporation – operates an underground infrastructure facility database through which subscribing companies are alerted of the need to perform line locates for landowners or contractors planning to excavate in Saskatchewan.

## Vision

We create superior value through innovative energy solutions.

## Mission

Our team of dedicated employees and business partners develops and delivers safe, reliable natural gas solutions that benefit our customers and Saskatchewan.

## Values

**Safety:** We never compromise the safety of our employees and the public.

**Community:** We are leaders in developing a diverse workforce, supporting our communities and environmental stewardship.

**Recognition:** We take time to recognize the individual and team contributions of our employees.

**Accountability:** We are accountable for our decisions, our actions and the results.

**Spirit:** We create a positive, welcoming and enjoyable work environment that supports employees in achieving their career goals and life balance.

**Communications:** We have open, honest and respectful communication that builds strong relationships.

**Integrity:** We are honest, respectful and apply high ethical standards.

## Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) highlights the primary factors that affected the operations and financial results of SaskEnergy and its wholly owned subsidiaries for the six month period ended June 30, 2010. The MD&A is as of August 24, 2010 and should be read in conjunction with the consolidated interim financial statements and accompanying notes. For additional information relative to its operations and financial position, refer to the Corporation's Annual Report for the year ended December 31, 2009.

The volume of natural gas distributed is sensitive to variations in the weather, particularly through the prime heating season of November to March. Therefore, the consolidated interim financial results should not be taken as indicative of the performance to be expected for the full year due to the seasonal nature of the natural gas utility business in Saskatchewan.

The following discussion contains certain forward-looking statements that are subject to inherent uncertainties and risks. The significant uncertainties and risks of the Corporation include natural gas price, winter weather, operational and regulatory. Consequently, actual results and events may vary significantly from those included in, contemplated or implied by such statements.

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| **Financial Highlights** | | | | |
| ($ millions) | | | | |
| Consolidated net income (loss) | (1) | (3) | 38 | 29 |
| Dividends | 12 | 5 | 27 | 20 |
| Capital expenditures | 22 | 22 | 42 | 46 |
| Total assets | | | 1,567 | 1,531 |
| Long-term debt | | | 795 | 791 |
| Debt ratio | | | 63% | 65% |
| **Operating Highlights** | | | | |
| Distribution | | | | |
| Volumes distributed - Petajoules | 28 | 24 | 74 | 75 |
| Weather - compared to the 30-year average | | | 2% warmer | 17% colder |
| Transmission | | | | |
| Volumes transported - Petajoules | 48 | 54 | 123 | 138 |
| Peak day natural gas flows (winter) - Petajoules | | | 1.07 | 1.18 |
| Date of peak flow | | | January 7 | January 24 |

## Consolidated Net Income (Loss)

For the six months ended June 30, 2010 consolidated net income was $38 million which was $9 million higher than the $29 million net income for the same period in 2009. The increase was principally due to favourable fair value adjustments of $15 million in 2010 versus $5 million in 2009.

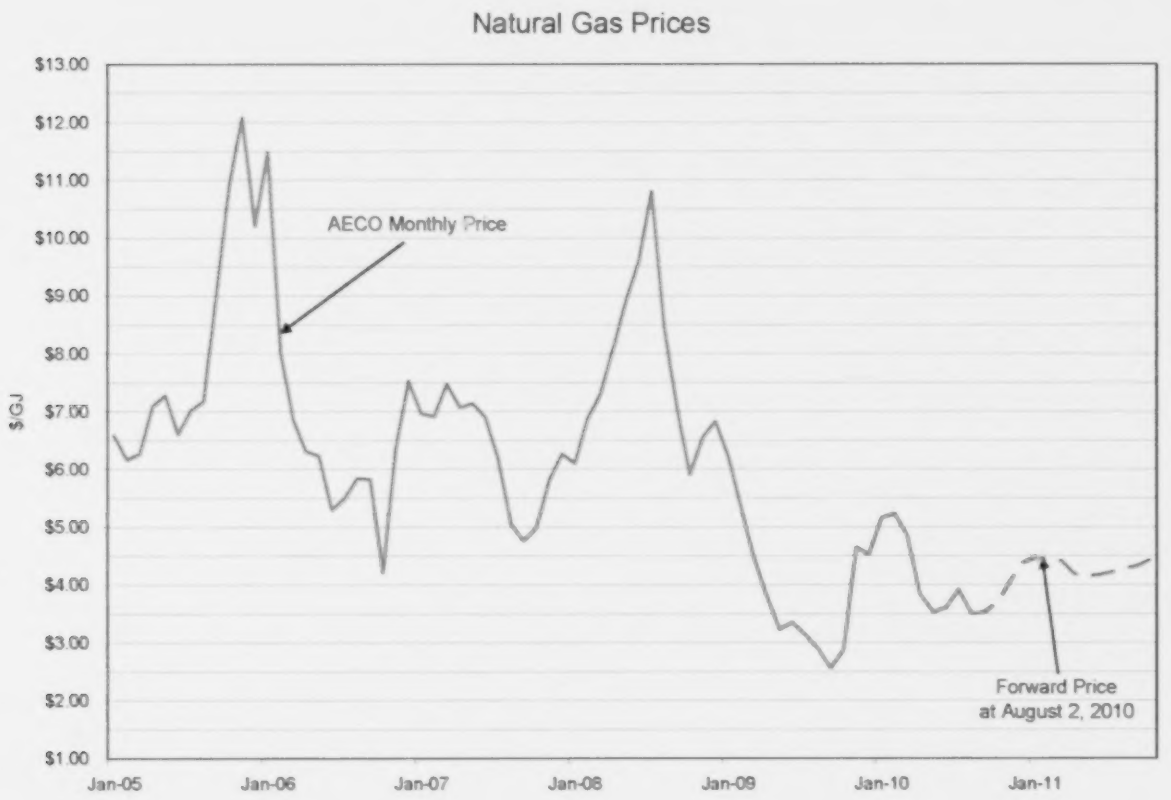
Given the seasonal nature of operations, SaskEnergy recorded a $1 million consolidated net loss for the second quarter of 2010 which was comparable to the $3 million consolidated net loss in the second quarter of 2009.

## Natural Gas Prices

Natural gas prices in Saskatchewan generally follow natural gas prices throughout North America. Natural gas producers continue to expend large amounts of capital drilling for natural gas from shale rock, which has created excess supply in North America. Demand for natural gas in the industrial sector has recovered significantly but is still below pre-recession levels. Winter weather added some support to natural gas prices early in 2010; however, prices have since moved lower.

SaskEnergy's commodity rate of $5.21 per Gigajoule (GJ), which became effective November 1, 2009, is scheduled for review this fall. The current commodity rate is SaskEnergy's lowest commodity rate since 2001.

The following is a chart of AECO natural gas prices. AECO is the major natural gas hub in Canada and is located in Alberta. Natural gas in Saskatchewan is priced at a differential to the AECO price and is usually about $0.05 per GJ to $0.10 per GJ higher than AECO.



## Commodity Margin

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| ($ per GJ) | | | | |
| Average commodity rate | 5.21 | 5.96 | 5.21 | 7.68 |
| Average cost of gas sold | 5.69 | 7.25 | 5.04 | 7.27 |
| ($ millions) | | | | |
| Realized margin on commodity sales | (4) | (11) | 5 | 16 |
| Impact of fair value adjustments | 14 | 12 | (18) | (12) |
| Margin on commodity sales | 10 | 1 | (13) | 4 |

The margin on commodity sales is affected by the volume of natural gas sold, the difference between the effective commodity rate and the purchase price paid for the natural gas sold and the change in fair value of natural gas contracts.

During the first six months of 2010 the weather was 2 per cent warmer than normal (normal determined by the 30-year average) compared to 17 per cent colder than normal during the same period in 2009. The warmer weather decreased the amount of natural gas consumed for space heating purposes by 5.0 Petajoules (PJ) compared to 2009.

During the first six months of 2010, the average cost of natural gas of $5.04 per GJ was lower than the average commodity rate of $5.21 per GJ, resulting in a realized commodity margin of $5 million before fair value adjustments. For the same period in 2009, there was a realized commodity margin of $16 million as the average cost of gas sold was $7.27 per GJ and the average commodity rate was $7.68 per GJ.

SaskEnergy utilizes a natural gas price risk management program to assist in managing the volatility of natural gas purchase prices so that the Corporation can deliver stable, competitive commodity rates to its customers. With purchase prices for natural gas often based on a floating index price, SaskEnergy may use natural gas contracts to effectively manage the future purchase price of natural gas. As financial and derivative instruments, these natural gas contracts are recorded at fair value on the Consolidated Statement of Financial Position. Between the time the natural gas contract is entered into and settled, changes in the fair value are recorded in the commodity cost of gas sold. For the six month period ended June 30, 2010 unfavourable fair value adjustments increased the cost of gas sold by $18 million, resulting in a loss on commodity sales of $13 million. In 2009 unfavourable fair value adjustments of $12 million resulted in a margin on commodity sales of $4 million.

For the second quarter of 2010 SaskEnergy realized a $4 million loss on commodity sales before the impacts of fair value adjustments as the average cost of gas sold of $5.69 per GJ exceeded the commodity rate of $5.21 per GJ. In 2009, there was a realized loss on commodity sales of $11 million as the average cost of gas sold of $7.25 per GJ exceeded the commodity rate of $5.96 per GJ. Favourable fair value adjustments of $14 million for the second quarter of 2010 were similar to the $12 million favourable fair value adjustments in 2009 resulting in margins on commodity sales of $10 million and $1 million respectively.

## Gas Marketing Margin

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| ($ millions) | | | | |
| Realized margin on gas marketing sales | 2 | (6) | 19 | 7 |
| Impact of fair value adjustments | (10) | 16 | 32 | 17 |
| | (8) | 10 | 51 | 24 |
| Revaluation of natural gas in storage | 9 | (6) | (12) | (21) |
| Margin on gas marketing sales | 1 | 4 | 39 | 3 |

In order to maximize the utilization of its assets during off-peak periods, SaskEnergy purchases and sells natural gas in the open market to earn a margin. SaskEnergy also competes to supply natural gas to larger end-use customers in Saskatchewan through non-regulated contract sales. Higher margins on gas marketing transactions during the first six months of 2010 resulted in a realized margin of $19 million compared to $7 million in 2009.

Given the volatility of market prices, gas marketing transactions are subject to natural gas price risk. Similar to the discussion related to the commodity margin, in order to manage natural gas price risk for its natural gas marketing activities, the Corporation may enter into natural gas contracts. These natural gas contracts are financial and derivative instruments and, as such, are recorded at fair value until the date of settlement. Changes in fair value are recorded in either gas marketing sales or gas marketing cost of gas sold, depending on the natural gas contract. For the period ended June 30, 2010 the margin from gas marketing activities was favourably impacted by fair value adjustments of $32 million. During the same period in 2009 there were favourable fair value adjustments of $17 million.

With the decline in natural gas market prices, the net realizable value for gas marketing natural gas in storage has fallen below cost. A downward revaluation of natural gas in storage of $12 million was recorded for the first half of 2010. If natural gas prices rise in the future, SaskEnergy will record an upward revaluation to recognize the increase in net realizable value, up to a maximum of the original cost. Otherwise, the $12 million will result in improved margins in the future as contracts are settled by virtue of the lower carrying value of natural gas in storage. For the same period in 2009, there was a downward revaluation of natural gas in storage of $21 million.

After the impact of fair value adjustments and the revaluation of natural gas in storage, the margin on gas marketing sales was $39 million for the six month period ended June 30, 2010. During the same period in 2009, the gas marketing margin after the impact of fair value adjustments and the revaluation of natural gas in storage was $3 million.

For the second quarter of 2010 the realized margin on gas marketing sales was $2 million which was further impacted by an unfavourable fair value adjustment of $10 million and an upward revaluation of natural gas in storage of $9 million resulting in a margin on gas marketing sales of $1 million. An upward revaluation of natural gas in storage was recorded due to the increase in natural gas market prices as well as the sale of natural gas in storage at a lower carrying value during the quarter. The second quarter of 2009 reported a $6 million realized loss on gas marketing sales, a favourable fair value adjustment of $16 million and a downward revaluation of natural gas in storage of $6 million resulting in a margin on gas marketing sales of $4 million.

### Delivery Revenue

The majority of SaskEnergy's distribution customers consume natural gas for heating purposes and, as a result, the volume of natural gas distributed is sensitive to variations in weather, particularly through the November-to-March prime heating load season. The weather from January 1 to June 30, 2010 was 2 per cent warmer than normal while the same period in 2009 was 17 per cent colder than normal resulting in a 4.2 PJ decline in natural gas consumption in 2010. Accordingly, delivery revenue for the first six months of 2010 was $99 million, $3 million lower than the same period in 2009. Effective January 14, 2010, SaskEnergy received approval for a delivery rate increase of $2.10 to the Basic Monthly Charge for residential customers and modest increases for other customer classes which partially offset the decline in natural gas consumption.

Delivery revenue for the second quarter of 2010 was $35 million which was $2 million higher than the second quarter of 2009. As volumes were comparable quarter over quarter, the variance was mainly due to the delivery rate increase in 2010.

### Transportation and Storage Revenue

Transportation and storage revenue for the first six months of 2010 was $39 million which was $1 million below the same period in 2009. Similarly, transportation and storage revenue for the second quarter of 2010 was $19 million versus $20 million for the second quarter of 2009.

During 2010 there was a continued decline in receipt and export volumes as natural gas production in Saskatchewan continued to decline. However, there was an offsetting increase in deliveries to industrial customers within the Province for 2010.

### Other Expenses

Operating and maintenance expenses for the six month period ended June 30, 2010 were $76 million which was $3 million higher when compared to the $73 million reported in the first six months of 2009. Likewise, operating and maintenance expenses for the second quarter of 2010 were $41 million versus $37 million for the second quarter of 2009. These increases were largely driven by an increase in construction activity somewhat offset by a focus on operating efficiencies. However, operating and maintenance expenses for the six month period were lower than anticipated in the Corporation's business plan.

Interest, amortization and Saskatchewan taxes to the end of June 30, 2010 were $1 million lower than the same period in 2009. On a quarterly basis, interest, amortization and Saskatchewan taxes were also $1 million lower in the second quarter of 2010 when compared to 2009. Lower interest expense on short- and long-term debt and higher debt retirement fund earnings were partially offset by higher amortization given a higher asset base in 2010.

## Liquidity and Capital Resources

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| ($ millions) | | | | |
| Cash provided by (used in) operating activities | 4 | (5) | 64 | 78 |
| Cash provided by (used in) investing activities | (14) | (15) | (25) | (30) |
| Cash provided by (used in) financing activities | 7 | 18 | (39) | (50) |
| Decrease in cash during the period | (3) | (2) | - | (2) |

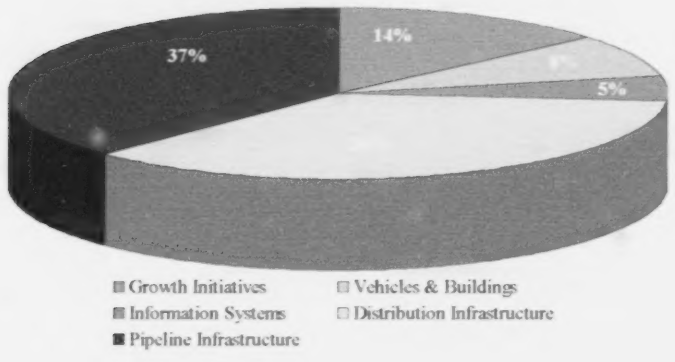
Cash from operations and debt borrowed from the Province of Saskatchewan's General Revenue Fund are the primary sources of liquidity and capital for SaskEnergy.

Cash provided by operating activities for the period ended June 30, 2010 was $64 million which was $14 million lower than the same period in 2009 mainly due to higher natural gas sales in 2009. Natural gas in storage held for resale increased $16 million from December 31, 2009 as SaskEnergy continued a strategy to purchase lower priced natural gas to increase storage levels. This additional natural gas in storage was purchased for gas marketing activities and will be held for resale in subsequent periods to generate additional margins and cash flow for the Corporation.

During the first six months of 2010 cash used for investing activities was $25 million compared to $30 million in 2009. The Corporation invested $42 million in capital projects, before customer capital contributions, as follows:

**Total Investment Activities**

Six Months Ended June 30, 2010




The majority of the investments made during the first six months of 2010 maintain the integrity of SaskEnergy's extensive distribution and pipeline infrastructure to ensure safe and reliable service. For the six months ended June 30, 2010 SaskEnergy connected 2,250 new customers to its distribution system. Additionally, SaskEnergy invested $6 million in new business development opportunities within Saskatchewan.

For the period ended June 30, 2010 $39 million was used for financing activities, a decline of $11 million from 2009. Cash provided by operations was sufficient that the Corporation did not issue any new short- or long-term debt and was able to pay dividends to its parent, CIC, of $36 million. Given relatively low debt balances, SaskEnergy's debt ratio was 63 per cent at the end of June 30, 2010, slightly better than its 65 per cent target.

## SaskEnergy International Incorporated

SaskEnergy, through SaskEnergy International Incorporated, holds a 30 per cent equity interest in Gas Sur S.A. (Gas Sur), a natural gas distribution company that serves residential and commercial customers in Chile. SaskEnergy began its investment in Gas Sur in 1999 and has a total capital investment of $14 million.

On February 27, 2010 an 8.8 magnitude earthquake struck Chile. While Gas Sur experienced damages to parts of its distribution system, natural gas service was restored to most of Gas Sur's customers at a cost of approximately $3 million. In addition, during the six month period ended June 30, 2010 Gas Sur recorded an asset write-down of $2 million.

To date, SaskEnergy is not anticipating a significant impact on the Corporation's financial statements. As at June 30, 2010 SaskEnergy's investment in Gas Sur was $15 million in the Consolidated Statement of Financial Position which includes SaskEnergy's share of the costs related to the earthquake, including the asset write-down.

SaskEnergy, through SaskEnergy International Incorporated, also holds a 40.1 per cent equity investment in IGASAMEX USA Ltd. (Igasamex), a natural gas transportation company in Mexico. SaskEnergy continues to work towards a pragmatic exit strategy from its equity holdings in both Gas Sur and Igasamex, in accordance with the Provincial Government's Saskatchewan First Investment Policy.

## Outlook

As the Saskatchewan economy continues to grow SaskEnergy expects continued strong demand for natural gas services. As the cleanest burning fossil fuel, the business and environmental benefits of natural gas will continue to make it the energy source of choice for many consumers. This expanding demand for natural gas is expected to result in continued growth for the well established distribution and transmission utilities. Opportunities beyond the Corporation's regulated utilities will further expand SaskEnergy's business within Saskatchewan and many of these opportunities, such as waste heat recovery, possess an environmental up-side as well. The Corporation anticipates additional margins from gas marketing activities as market opportunities become available.

With a solid financial position and a positive outlook for the future, the Corporation anticipates strong financial returns with a net income target of $53 million for 2010. The target for annual net income excludes the impacts of fair value adjustments for financial and derivative instruments and revaluation of natural gas in storage as these adjustments are not known until the end of the fiscal year. The annual net income target has decreased $5 million from the $58 million projected during first quarter of 2010 as warmer than normal weather and lower contracted receipts and exports have affected delivery and transportation and storage revenues. These projected lower revenues have been partially offset by lower operating and interest expenses.

All internal costs are closely managed in an effort to minimize future rate adjustments for SaskEnergy's regulated businesses. The Corporation's operations will continue to focus on maintaining safe reliable systems and high levels of customer service.

## Future Accounting Changes - International Financial Reporting Standards (IFRSs)

Effective January 1, 2011, publicly accountable Canadian entities will be required to prepare financial information in accordance with IFRSs. The Public Sector Accounting Board has approved an amendment to the scope of public sector accounting standards. The amendment confirms that Government Business Enterprises, including SaskEnergy, will be required to follow IFRSs for periods beginning on or after January 1, 2011. This will allow for a comparison of similar entities in the public and private sector.

As part of the IFRSs conversion project, SaskEnergy has developed a detailed IFRSs implementation plan. An external advisor was engaged to assist with project development and implementation. The advisor supported in

performing a detailed review of major differences between current Canadian generally accepted accounting principles (GAAP) and IFRSs. SaskEnergy is in the final stages of determining its accounting policies and the impact IFRSs will have on SaskEnergy's future financial position and operational results. In conjunction with evaluating the accounting standards, a review of the information technology and data systems' capability to provide the information required by IFRSs has been performed. Modifications have been made to certain processes and systems to ensure transactions are recorded in accordance with IFRSs. Management and staff from SaskEnergy have participated in IFRSs training seminars. Board members have been briefed on IFRSs, participated in high level training and reviewed and approved project plans.

The most significant areas of difference between IFRSs and Canadian GAAP that will impact SaskEnergy are related to the accounting policies for property, plant and equipment and financial statement presentation and disclosure.

For additional information related to these future changes in accounting policies, refer to Note 1 of the consolidated interim financial statements.

## SASKENERGY INCORPORATED
## Consolidated Statement of Financial Position
**(millions)**

| | As at June 30, 2010 (unaudited) | As at December 31, 2009 (audited) |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Accounts receivable | $ 56 | $ 113 |
| Natural gas in storage held for resale (Note 2) | 274 | 258 |
| Inventories of supplies | 8 | 9 |
| Debt retirement funds | 10 | 9 |
| Fair value of derivative instruments (Note 3) | 78 | 52 |
| | 426 | 441 |
| Intangible assets | 14 | 15 |
| Property, plant and equipment | 1,012 | 1,004 |
| Natural gas in storage held for resale and operations (Note 2) | 34 | 34 |
| Debt retirement funds | 53 | 48 |
| Investments | 28 | 30 |
| | $ 1,567 | $ 1,572 |
| **Liabilities and Province of Saskatchewan's Equity** | | |
| Current liabilities | | |
| Bank indebtedness | $ 1 | $ 1 |
| Short-term debt | 108 | 108 |
| Accounts payable | 108 | 126 |
| Dividends payable | 12 | 21 |
| Current portion of long-term debt | 80 | 80 |
| Fair value of derivative instruments (Note 3) | 50 | 38 |
| | 359 | 374 |
| Asset retirement obligations | 8 | 8 |
| Long-term debt | 715 | 715 |
| | 1,082 | 1,097 |
| Province of Saskatchewan's equity | | |
| Retained earnings | 417 | 406 |
| Accumulated other comprehensive loss | (4) | (3) |
| | 413 | 403 |
| Equity advances | 72 | 72 |
| | 485 | 475 |
| | $ 1,567 | $ 1,572 |

Commitments and contingencies (Note 5)

(See accompanying notes)

# SASKENERGY INCORPORATED
## Consolidated Statement of Income (Loss) and Retained Earnings
**(millions)**
**(unaudited)**

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| **Revenue** | | | | |
| Commodity sales | $ 42 | $ 53 | $ 161 | $ 310 |
| Gas marketing sales | 42 | 92 | 189 | 218 |
| Delivery | 35 | 33 | 99 | 102 |
| Transportation and storage | 19 | 20 | 39 | 40 |
| Revenue collected for municipalities | 4 | 4 | 12 | 17 |
| Other | 1 | 1 | 3 | 4 |
| | 143 | 203 | 503 | 691 |
| **Expenses** | | | | |
| Commodity cost of gas sold | 32 | 52 | 174 | 306 |
| Gas marketing cost of gas sold | 41 | 88 | 150 | 215 |
| Operating and maintenance | 41 | 37 | 76 | 73 |
| Interest | 9 | 11 | 19 | 22 |
| Amortization | 15 | 14 | 30 | 28 |
| Payment to municipalities | 4 | 4 | 12 | 17 |
| Saskatchewan taxes | 2 | 2 | 4 | 4 |
| | 144 | 208 | 465 | 665 |
| Net income (loss) from continuing operations | (1) | (5) | 38 | 26 |
| Net income from discontinued operations | - | 2 | - | 3 |
| Net income (loss) | (1) | (3) | 38 | 29 |
| Retained earnings, beginning of period | 430 | 381 | 406 | 364 |
| Dividends | (12) | (5) | (27) | (20) |
| Retained earnings, end of period | $ 417 | $ 373 | $ 417 | $ 373 |

(See accompanying notes)

## SASKENERGY INCORPORATED
## Consolidated Statement of Comprehensive Income (Loss)
**(millions)**
**(unaudited)**

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net income (loss) | $ (1) | $ (3) | $ 38 | $ 29 |
| Other comprehensive income (loss) | | | | |
| Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations | 1 | - | (1) | 2 |
| Comprehensive income (loss) | $ - | $ (3) | $ 37 | $ 31 |

## SASKENERGY INCORPORATED
## Consolidated Statement of Accumulated Other Comprehensive Loss
**(millions)**
**(unaudited)**

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Accumulated other comprehensive loss, beginning of period | $ (5) | $ (1) | $ (3) | $ (3) |
| Other comprehensive income (loss) | 1 | - | (1) | 2 |
| Accumulated other comprehensive loss, end of period | $ (4) | $ (1) | $ (4) | $ (1) |

(See accompanying notes)

# SASKENERGY INCORPORATED
## Consolidated Statement of Cash Flows
**(millions)**
**(unaudited)**

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| **Operating Activities** | | | | |
| Net income (loss) | $ (1) | $ (3) | $ 38 | $ 29 |
| Add (deduct) items not affecting cash (Note 4) | 1 | (10) | 26 | 42 |
| Net change in non-cash working capital related to operations | 4 | 7 | - | 8 |
| Cash provided by (used in) continuing operations | 4 | (6) | 64 | 79 |
| Cash provided by (used in) discontinued operations | - | 1 | - | (1) |
| Cash provided by (used in) operating activities | 4 | (5) | 64 | 78 |
| **Investing Activities** | | | | |
| Additions to property, plant and equipment | (21) | (22) | (40) | (46) |
| Capital contributions and deposits received | 8 | 7 | 17 | 16 |
| Additions to intangible assets | (1) | - | (2) | - |
| Cash used in investing activities | (14) | (15) | (25) | (30) |
| **Financing Activities** | | | | |
| Increase in bank indebtedness | 1 | - | - | - |
| Increase (decrease) in short-term debt | 23 | 46 | - | (65) |
| Proceeds from long-term debt | - | - | - | 50 |
| Repayments of long-term debt | - | (11) | - | (11) |
| Debt retirement fund installments | (2) | (2) | (3) | (3) |
| Dividends paid | (15) | (15) | (36) | (21) |
| Cash provided by (used in) by financing activities | 7 | 18 | (39) | (50) |
| Decrease in cash during the period | (3) | (2) | - | (2) |
| Cash position, beginning of period (Note 4) | 3 | 4 | - | 4 |
| Cash position, end of period (Note 4) | $ - | $ 2 | $ - | $ 2 |

(See accompanying notes)

**SaskEnergy Incorporated**
**Notes to the Consolidated Financial Statements**
**June 30, 2010**

*Unaudited*

## 1. Accounting Policies

SaskEnergy Incorporated (SaskEnergy or the Corporation) prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles (GAAP). The disclosures do not conform in all respects to the requirements for annual financial statements. The consolidated interim financial statements follow the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2009.

These consolidated interim financial statements, which are unaudited, should be read in conjunction with the consolidated financial statements for the year ended December 31, 2009 and have been prepared from the records of the Corporation. The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The inherent uncertainty involved in making such estimates and assumptions may impact the actual results reported in future periods.

The consolidated interim financial statements should not be taken as indicative of the performance to be expected for the full year due to the seasonal nature of the natural gas utility business in Saskatchewan.

a. Future accounting policy changes

The Canadian Institute of Chartered Accountants (CICA) has issued several new Handbook Sections: Section 1582 – Business Combinations, Section 1601 – Consolidated Financial Statements and Section 1602 – Non-Controlling Interests for fiscal years beginning on or after January 1, 2011. These sections replace existing Handbook Sections 1581 and 1600 and establish standards for the accounting for business combinations, preparation of consolidated financial statements and accounting for a non-controlling interest in a subsidiary. The Corporation is evaluating the potential impacts of these accounting recommendations and does not anticipate a significant impact on the Corporation's financial statements.

The CICA has announced that publicly accountable Canadian entities will be required to prepare financial information in accordance with International Financial Reporting Standards (IFRS) effective January 1, 2011. Although IFRS are a principle-based set of standards, similar to current GAAP, there are areas where the accounting treatment differs from Canadian GAAP. The Corporation is evaluating the potential impacts of IFRS on the Corporation's financial statements.

## 2. Natural Gas in Storage Held for Resale and Operations

For the six months ended June 30, 2010 $264 million of natural gas in storage held for resale (2009 - $399 million) was recognized as cost of gas sold. With the decline in natural gas market prices, the net realizable value of gas marketing natural gas in storage has fallen below cost. For the six months ended June 30, 2010 there was a $12 million write-down of natural gas in storage held for resale to its net realizable included in gas marketing cost of gas sold (2009 - $21 million). If natural gas prices rise in the future, there will be a reversal of the write-down. There was no reversal of any prior year write-down during the period.

## 3. Financial Instruments and Risk Management

a. Financial instruments

The fair value of the Corporation's financial instruments is listed below:

| | June 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (millions) | | | |
| **Other liabilities** | | | | |
| Long-term debt | $ 795 | $ 889 | $ 795 | $ 889 |
| **Held-for-trading** | | | | |
| Debt retirement funds | 63 | 63 | 57 | 57 |

The fair value of the above instruments was based on the following:

i. Long-term debt – The present value of future cash flows discounted at the market rate of interest for the equivalent Province of Saskatchewan debt instruments.

ii. Debt retirement funds – The fair value measurements are calculated using Level 2 inputs. The market value of the investments held in the debt retirement fund is determined by Saskatchewan's Ministry of Finance using information provided by investment dealers. To the extent possible, valuations reflect indicative secondary pricing for these securities. In all other circumstances, valuations are determined with reference to similar actively traded instruments.

The fair value of other financial instruments, including cash, accounts receivable, bank indebtedness, short-term debt, accounts payable and dividends payable approximate their carrying values due to the short-term nature of the instruments.

b. Natural gas derivative instruments

The fair value of natural gas derivative instruments held-for-trading, with the exception of natural gas price options, is calculated daily and is based on quoted market prices. The Corporation obtains information from sources such as the New York Mercantile Exchange and the Natural Gas Exchange, independent price publications and over-the-counter broker quotes. All of the Corporation's recurring fair value measurements are calculated using Level 2 inputs. The fair value of natural gas price options is determined using the Garman-Kohlhagen model which requires the use of various assumptions, including quoted market prices, interest rates and volatility estimates for forward natural gas prices which are each based on external market sources. For physical natural gas contracts notional values are an approximation of future net cash flows based on contract price multiplied by contract quantity. For other derivative instruments, the notional value is the difference between the contract price and the market price. SaskEnergy has sufficient borrowing capacity to fund these contractual obligations. Where contract prices are referenced to an index price that has not yet been fixed, the market price at June 30, 2010 has been used to estimate the contract price. At June 30, 2010, all derivative assets and liabilities held-for-trading are recorded on the consolidated statement of financial position at fair value.

## 3. Financial Instruments and Risk Management (continued)

As at June 30, 2010, natural gas derivative instruments held-for-trading had the following fair values, notional values and maturities:

| | 2010 | 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|---|
| | | | (millions) | | | |
| Physical natural gas contracts | | | | | | |
| Fair value | $ 10 | $ 2 | $ - | $ 1 | $ - | $ 13 |
| Notional value | (15) | 24 | 6 | 2 | - | 17 |
| Natural gas price swaps | | | | | | |
| Fair value | (13) | 1 | (6) | 33 | - | 15 |
| Notional value | (13) | 1 | (6) | 33 | - | 15 |
| Total | | | | | | |
| Fair value | $ (3) | $ 3 | $ (6) | $ 34 | $ - | $ 28 |
| Notional value | $ (28) | $ 25 | $ - | $ 35 | $ - | $ 32 |

Fair value - increase (decrease)
Notional value - estimated net cash inflow (outflow)

c. Changes in fair value

The fair value of derivative instruments is presented on the consolidated statement of financial position as follows:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| | (millions) | |
| Fair value of derivative instrument assets | $ 78 | $ 52 |
| Fair value of derivative instrument liabilities | (50) | (38) |
| | $ 28 | $ 14 |

## 3. Financial Instruments and Risk Management (continued)

The change in fair value of financial and derivative instruments is recorded in net income within the relevant revenue or expense category. For the six months ended June 30 the increase (decrease) in net income of these unrealized gains and losses was as follows:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (millions) | | (millions) | |
| Derivative instruments | | | | |
| Gas marketing sales | $ (16) | $ 3 | $ 29 | $ 33 |
| Commodity cost of gas sold | 14 | 12 | (18) | (12) |
| Gas marketing cost of gas sold | 6 | 13 | 3 | (16) |
| | 4 | 28 | 14 | 5 |
| Financial instruments | | | | |
| Interest expense | 1 | - | 1 | - |
| | $ 5 | $ 28 | $ 15 | $ 5 |

d. Risk management

The Corporation uses various derivative financial instruments to manage the risks associated with its operating exposures to fluctuations in foreign currency exchange rates, interest rates and the price of natural gas. A Corporate Derivatives Policy and specific risk management strategies establish the guidelines within which such derivative financial instruments may be used.

i. Natural gas price risk

The Corporation may manage the risk associated with the purchase and sale price of natural gas. The purchase or sale price of natural gas may be fixed within the contract, or referenced to a floating index price. When the price is referenced to a floating index price, natural gas derivative instruments may be used to fix the settlement amount. The types of natural gas derivative instruments SaskEnergy may use for price risk management include natural gas price swaps, options, swaptions and futures contracts.

Based on the Corporation's June 30, 2010 closing positions, an increase of $1.00 per Gigajoule in natural gas prices would have increased net income, through an increase in the fair value of natural gas contracts, by $9 million. Conversely, a decrease of $1.00 per Gigajoule would have decreased net income, through a decrease in the fair value of natural gas contracts, by $9 million.

ii. Credit risk

The Corporation is exposed to credit risk through cash, accounts receivable, debt retirement funds and derivative instrument assets. Credit risk related to cash and debt retirement funds is minimized by dealing with institutions that have strong credit ratings and holding highly-rated financial securities.

## 3. Financial Instruments and Risk Management (continued)

The Corporation extends credit to its customers in the normal course of business and is at risk of loss in the event of non-performance by counterparties on certain of the financial instruments described above. To reduce its credit risk, SaskEnergy has established policies and procedures to monitor and limit the amount of credit extended to its customers and counterparties and may require letters of credit and other forms of security. At June 30, 2010 the maximum credit exposure to a single counterparty was $20 million (December 31, 2009 - $14 million).

Derivative credit risk arises from the possibility that a counterparty to a contract fails to perform according to the terms and conditions of that contract. Derivative credit risk is minimized by dealing with creditworthy counterparties in accordance with established credit approval policies.

The carrying amount of financial and derivative assets represents the maximum credit exposure as follows:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| | (millions) | |
| Accounts receivable | $ 56 | $ 113 |
| Debt retirement funds | 63 | 57 |
| Fair value of derivative instrument assets | 78 | 52 |
| | $ 197 | $ 222 |

## 4. Supplementary Cash Flow Information

a. Cash position

| | June 30, 2010 | June 30, 2009 |
|---|---|---|
| | (millions) | |
| Cash from continuing operations | $ - | $ - |
| Cash from discontinued operations | - | 2 |
| | $ - | $ 2 |

## 4. Supplementary Cash Flow Information (continued)

b. Items not affecting cash from operations

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (millions) | | | |
| Amortization | $ 15 | $ 14 | $ 30 | $ 28 |
| Write-down of natural gas in storage held for resale | (9) | 6 | 12 | 21 |
| Change in fair value of derivative instruments | (4) | (29) | (14) | (4) |
| Debt retirement funds earnings | (1) | - | (2) | (1) |
| Change in fair value of debt retirement funds | (1) | - | (1) | - |
| Equity earnings | 1 | 1 | 1 | - |
| Net income from discontinued operations | - | (2) | - | (3) |
| Other | - | - | - | 1 |
| | $ 1 | $ (10) | $ 26 | $ 42 |

## 5. Commitments and Contingencies

In April 2010, the Corporation was charged under Saskatchewan's Occupational Health and Safety Act and Regulations in relation to a natural gas explosion that occurred April 18, 2008 in Nipawin, Saskatchewan. The Corporation has also been named a defendant in a number of civil actions related to this incident. The claims remain at an early stage, and the Corporation has not yet entered a plea on the charges. Accordingly, the likelihood and amount of any potential loss cannot be reasonably estimated. Consequently, the Corporation has not recorded a liability for this contingency as at June 30, 2010.

## 6. Comparative Figures

Certain of the prior period's figures have been reclassified to conform to the current period's presentation.